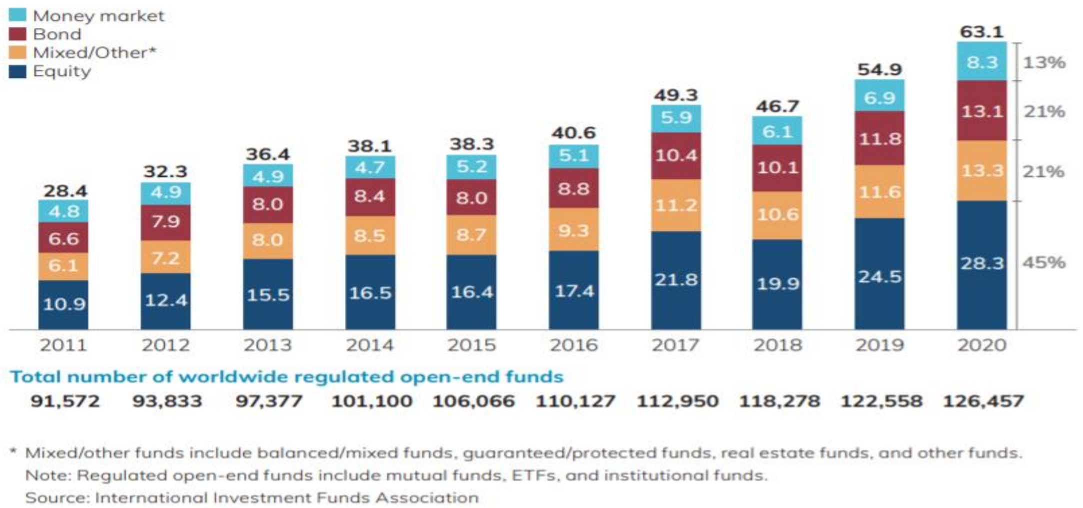
CHAPTER I

Introduction

1.1. Research Background

The Equity mutual funds have been growing significantly from period 2011 to 2020 by 159.63%. (More, 2018). However, this significant grow is not followed by significant return which is generated by this investment instrument. Ferreira et al., (2012) investigated the performance of equity mutual funds in 27 countries around the world and found that performances of the observed equity mutual fund were underperform the market. Similar research in India over 240 observed equity mutual funds found that less than 10% of those equity funds could outperform the market return (Agarwal & Pradhan, 2019). Research in China also found that from 419 of observed equity funds in China, it was only 1% of them outperform the market return (Sherman et.al, 2017). And, from 194 of equity mutual funds observed in Germany, none of the funds could outperform the market return (Fahling et al., 2019).



Picture 1.1 - Total Number of Worldwide Regulated Open-end Funds

The abovementioned researches of many results showed consistency in many regions that most of equity mutual funds failed to deliver the outperform return. If performance of this investment instrument is not improved, the investors may no longer consider equity mutual funds as one of promising investment instrument which is unfavorable to the capital market. This investment instrument is important to attract investors, especially those investors with less investment knowledge but with significant available capital to invest.

Investment strategy is one of the key factors to generate the outperform return. The right investment strategy shall be implemented in the right way (Wu et al., 2021); (Juddoo et al., 2021). Some researchers suggested that under certain circumstances the right investment strategy with adaptation some technology in it earns significant excess return (Van der Hart, et al., 2003); (G. Li et al., 2021); (Purba et al., 2018).

In theoretical perspective, there are two major investment strategies which are active investment strategy and passive investment strategy. These two strategies have been debated by many researchers especially on its respective superiority to the other in order to deliver investment return. The existence of these theories have been developed by some assumptions or empirical evidence the past which may no longer suitable with the current condition therefore these two strategies cannot generate the outperform return.

The passive investment theory based on assumption that market is efficient that price reflects all information available in the market. Hence, the market price is predictable, no need to participate in active trading (Lucas & Sanz, 2016); (Y. Li, 2020); (Akperov et al., 2018). Fama who promoted this theory proposed to evaluate investment performance by using this theory into parts resulting from the ability to pick the best securities at a given level of risk, and the part that is result of prediction of market movement. From the theory principles and this model, the researcher conclude that the key of the investment performance is on selection ability. For equity mutual funds, the key will be the *stock selection ability* that the selected stocks are predicted to generate return in the future.

The weakness of the passive investment theory is on its assumption that there is no efficient market in actual world. Hence, the price of equity does not reflects all information available in the market. And, as the market keeps changing and so is the investment risk, the future return is not predictable. Therefore, the investment fund manager may need to take some action, at the right time, in order to market and risk changes which is not only to avoid loss, but also to maximize the investment return. Otherwise, it is impossible for equity mutual fund to generate the outperform return (Skuciene & Markeviciute, 2021); (Wang & Hao, 2020). The researcher call the capability to take the right action at the right time as market timing ability. The research will propose empirical evidence that this market timing ability is important to be added as part of passive investment strategy.

The other investment strategy, active investment strategy, requires to be actively involved in the trading by continuously monitoring the market and take proper decision to outperform market return (Yang et al., 2020); (Dzwigol & Dzwigol-Barosz, 2020); (Stern et al., 2020). The strategy uses all information and chooses benchmark to outperform it through trading activities. (Sushko & Turner, 2018). In theory, by doing this, the equity mutual fund should earn outperform return (Dadashi, 2020);

(Rao-Nicholson & Svystunova, 2020); (Mehta et al., 2019). During the active trading, the investment fund manager needs to decide whether to add to or remove from to the portfolio at the right time. Therefore, they supposedly must have strong capability in *stock selection* and strong *market timing capabilities*. However, research proved that very few equity mutual funds could generate the outperform return. (Y. Li et al., 2019; Zhang & Chen, 2019; Shokhnekh et al., 2019). Therefore, this research will be conducted in order to propose empirical evidence of what factors must be considered and/or analyzed by the investment fund manager in managing equity mutual funds by using the active investment strategy hence the equity mutual funds could generate outperform return.

Research proved that stock selection ability and market timing ability are important in managing equity mutual funds for these two abilities influenced performance of equity mutual funds. (Devi & Sudirman (2021); (Gusni et al., 2018; Woltering et al., 2018). These two abilities significantly contribute to the funds' performances (Jian et.al, 2021). And, the implementation of these two abilities resulted outperform return. (Ahmad & Alsharif, 2019). However, many researches proved very few equity mutual funds were managed with the strong stock selection and market timing abilities (Agarwal & Pradhan, 2019; Sherman et.al., 2017). Hence, the equity mutual funds could not outperform the market return. (Fahling et al., 2019).

The previous research more focused on the existence or the quality of stock selection and market timing ability of the fun managers in managing the equity mutual funds. Rarely discussed of reason on the lack of strong or significant stock selection and marke timing abilities. Therefore, to fill the research gap, this research will be conducted in order to propose a pieace of novel empirical evidence of determinant factors must be established and managed by investment fund manager to generate the outperform return, and to build the strong stock selection and market timing ability. The researcher has confident that if all of these factors are properly evaluated, monitored, managed, by the investment fund manager, the performance of equity mutual funds will be improved. It will more possible to beat the market which eventually to generate the outperform return.

This research will be conducted on equity mutual funds in ASEAN Markets (Indonesia, Malaysia, Singapore, Thailand, Philippines). The ASEAN markets are mainly consisting of emerging countries which are attractive for investors, either investors who come from within the region or investors from outside the region. Based on ASEAN investment repot released by The ASEAN Secretariat (2021), ASEAN market was the largest recipient of foreign direct investment ("FDI"). The ASEAN's GDP (Gross Domestic Product), as of 2019, contributed to 3.3% of global GDP and produced more than 7% of global export that makes ASEAN is the world's fourth largest of exporting region (OECD Development Centre, 2019) which makes this region as the sixth largest economic block in the world. Based on data from statista.com, it is predicted that the total of asset under management in ASEAN as of 2020 is USD516.6billions which significantly grow since 2015 (USD295.6 billions) (More, 2018).

Based on the abovementioned data, this region is a promising investment markets. With the fact that most countries of this region are emerging countries, its people's financial literacy may not be as good as people in developed countries.

Therefore, the equity mutual funds is one of the best option for investment, so that it is important to propose empirical evidence on how to improve performance of equity mutual funds within the region from perspective of investment strategy.

Table 1.1 – Summary Phenomena from Recent Studies

Researchers	Publisher	Observation and Result
Fahling et.al, 2019	Journal of Financial Risk Management	Observation on 194 equity mutual funds in Germany. None of these funds generated outperform return
Ferreira et.al, 2019	Review of Finance, European Finance Association.	Observation on equity mutual funds from 27 countries – In general all equity mutual funds were underperform.
Agarwal & Pradhan, 2019	Cogent Economics and Finance	Observation on Indian equity mutual funds period 2006 to 2015. The funds were underperform due to lack of stock selection and market timing abilities.
Sherman, M., at.al, 2017	International Journal of Finance Study	Observation on 419 of Chinese equity funds. The equity mutual funds could not generate the outperform return due to lack of market timing ability

1.2. Research Objectives

ASEAN countries are attractive countries for investors for most of members of ASEAN countries are still developing their economy and standard of living that makes these countries needs capital inflow. (Chaisrisawatsuk, 2016). Most of countries in this region are still categorized as emerging countries which according to (Beach, 2006), emerging countries provided sufficient return on equity market to compensate the investment risk.

This research select 4 (four) emerging countries from this region (Indonesia, Malaysia, Thailand and Philippines) and one developed country (Singapore) to study how effective the investment strategy is implemented in this region, factors impacting performance of equity mutual funds to outperform hence this shall be managed carefully by using the determined investment strategy, and factors affecting ability of the fund manager to select the right underlying assets and to take proper investment decision to deal with the volatile market condition hence the investment risk is managed and the outperform return can be generated.

This research aims to contribute to the development of investment strategy as well as proposing enhancement of the existing performance model hence the theory of investment strategy is more in line with the market development and the model can result better evaluation on the equity mutual fund performance.

Furthermore, this research also aims to proposed factors that impacting the way the investment fund manager in implementing the determined strategy in managing performance of equity mutual funds. Hence, the strategy can be more effective to generate outperform return.

1.3. Research Questions

There might be gap between existing conditions with the expected ideal situation, which in research we acknowledged this as problem (Uma & Roger, 2016). One of objective of investors/traders to trade in capital market is to gain profit as much as they can. Therefore, the investment managers as those who sell equity funds to the investors shall decide which strategy suitable to maximize their return by outperforming the market return.

Previous researches, as described in introduction section, showed that there were very few equity funds in the market could outperform the market return. The researcher postulate this because failure in executing the determined investment strategy by the investment fund managers for they did not have significant ability in stock selection and strong ability determining the right action to deal with the market condition. This idea derived from similar researchers that found most of equity funds were not managed with significant stock selection and market timing abilities. (Agarwal & Pradhan, 2019). Whilst, many researchers showed evidence that stock selection and market timing abilities affect and/or influence the performance of equity mutual funds. (Jian et al., 2021; Devi & Sudirman, 2021; Lailiyah & Setiawan, 2020)

Following list of items to be addressed in this research in order to understand independent variables that might influence of performance of equity mutual funds in ASEAN market to earn outperform return and factors affecting the stock selection and market timing abilities of the fund managers. Hence, the determined investment strategy can be effectively used in order to earn outperform return:

A. What is the percentage of equity mutual funds in the ASEAN market with outperforming returns as evidence of the implemented investment strategy?

B. What is the percentage of equity mutual funds managed with stock selection ability?

C. What is the percentage of equity mutual funds which are managed with market timing ability?

D. What factors affect the excess return of the equity mutual funds in the ASEAN market?

E. What factors impact the investment manager's stock selection ability in managing equity mutual funds in ASEAN Market?

   E.1. What is the impact of the growth in fund size on the stock selection ability of the fund manager?

   E.2. What is the impact of volatility of performance of equity mutual funds on the selection ability of the fund manager?

   E.3. What are equities performance indicators affecting the fund manager's stock selection ability?

F. What are factors impacting the market timing ability of the investment manager in managing equity mutual funds in the ASEAN market:

   F.1. what are macroeconomic indicators which impact the market timing ability of the investment fund managers?

   F.2. what is the impact of the growth of fund size on the market timing ability of the investment fund managers?

F3. What is the impact of the volatility of the equity funds' performance on the market timing ability of the fund managers?

1.4. Research Benefits

There have been many researches in investment strategy tried to defend their position by concluding certain investment strategy is superior to the other investment strategy to maximize the investment return. Many researchers also proof that stock selection ability and market timing abilities, which are part of investment strategy, affected the performance of equity mutual funds. However, rarely of them conducted the research to not only conclude that one strategy is superior to other but also to clearly understand of why such strategy failed to outperform market return; whether the investors and/or the investment manager implement the strategy by having sufficient stock selection ability as well as market timing ability and factors affecting those abilities.

The actual benefit of this research is to promote comprehensive of empiric analysis of why the investment strategy failed to deliver outperform returns and what factors shall be carefully considered in implementing the investment strategy hence the investment return will outperform the market return.

1.4.1. Practical Contribution

This research proposes empirical evidence for the finance practitioner that the way an investment strategy implemented during this times c could not generate outperform return. Therefore, this research proposed factors shall be considered in establishing and managing equity mutual funds hence the determined investment strategy can be effectively implemented to earn outperform return. Furthermore, the proposed model on this research can also be used to evaluate more comprehensively performance of equity mutual funds by combining perspective of stock selection and market timing abilities as well as all other factors affecting performance of an equity mutual funds.

1.4.2. Theoretical Contribution

The existing theory of the two investment strategies; active and passive strategies, shall be enhanced as for decades the researchers found most of equity mutual funds could not outperform market return. This research aims to contribute to the enhancement of theory of strategic investment by promoting empirical evidences on factors affecting outperform return which without these factors, the equity mutual funds cannot deliver outperform return, therefore these factors are important to consider and to analyze.

Furthermore, this research aims to contribute to the enhancement of performance evaluation model which was established by Treynor and Mazuy (1966) that this model evaluate performance of mutual funds suggested in order to outperform, an investment fund manager must have stock selection ability and market timing ability. The enhancement of this model is conducted by adding new other factors which will affect an equity mutual fund to earn outperform return. Therefore, the model could be better in evaluating performance of equity mutual funds as well as to predict whether the equity mutual funds will earn outperform return.

In addition, this research also proposes empirical evidence to all factors affecting stock selection ability and market timing abilities hence the existing theory of passive and active investment strategies can be enhanced accordingly.

1.5. Writing Systematic

This dissertation is written in five chapters with some sub-chapters will be organized. Chapter one covers basic thinking of why this research should be conducted. This chapter covers recent researches in investment strategy, portfolio performance, stock selection and market timing abilities. There are problems identified in this chapter which then the researcher formulized it in the form of research questions which needs to be answered through empirical analysis. The researcher hopes to contribute to development of related finance theory, to be specific, the development of theory of investment strategy, theory of portfolio and mutual funds investment to be used by both academician and practical world.

Chapter two covers background from theoretical perspective to construct model of empirical research and variables being used in the constructed models. There will be hypotheses developed in this chapter which formulized as temporary answer to the identified research questions which later on must be tested in the following chapters.

Chapter three covers research methodology being used in this research; to collect and organize data, analyze data from the identified research objects and unit of analysis. This chapters also covers methodology being used to test validity and reliability of the model being developed.

Chapter four will cover result of the data analysis in order to answer the formulized research questions. In this chapter, the researcher will be presenting the empirical evidence of equity funds with excess return that the investment managers have stock selection and market timing ability and factors influence these abilities. Furthermore, this chapter will also present what makes difference between equity funds with excess return and equity funds without excess return.

Chapter five will cover research conclusion, practical implication, and recommendation for future researcher who aim to contribute to development of theory of portfolio, investment strategy, market timing.